STATE OF CALIFORNIA
ENERGY RESOURCES CONSERVATION
AND DEVELOPMENT COMMISSION

Implementation of Renewables Portfolio Standard Legislation (Public Utilities Code Sections 381, 383.5, 399.11 through 399.15, and 445; [SB 1038], [SB 1078])	**))))**	**Docket No. 03-RPS-1078 RPS Proceeding Staff Workshop on Phase II Issues**

COMMENTS OF THE
CALIFORNIA WIND ENERGY ASSOCIATION
ON THE MAY 12, 2003 STAFF WORKSHOP
QUESTIONS ON RPS PHASE IMPLEMENTATION ISSUES:
SUPPLEMENTAL ENERGY PAYMENT GUIDELINES

The California Wind Energy Association ("CalWEA") appreciates this opportunity to provide written responses to the questions presented for discussion at the May 12, 2003, Staff Workshop on Phase II RPS implementation issues.[1] These comments, attached below, elaborate further on the comments made by CalWEA on Supplemental Energy Payment (SEP) guidelines.

Thank you for considering our views. Please contact me if I can provide further information on any of our comments.

Respectfully submitted,

_________/s/_________
Nancy Rader
Executive Director
California Wind Energy Association
1198 Keith Avenue
Berkeley, CA 94708
(510) 845-5077
nrader@igc.org

May 16, 2003

[1] CalWEA represents over 20 members of the wind energy industry, including owners of existing projects, developers of new projects, turbine manufacturers, and other vendors.

Responses of the California Wind Energy Association to the Questions on Phase II RPS Implementation Issues: Supplemental Energy Payment (SEP) Guidelines

Funding Eligibility

1. How should the CEC define "New" for the purpose of SEP eligibility? For example, should "New" be defined as coming online after a specific date? If so, what date is appropriate? If such a date is chosen, does the "New" designation apply forever, or does it expire after some period of time?

As provided in SB 1038 (P.U. Code § 383.5(d)(2)), the "new" renewables funds should be spent in accordance with Chapter 3, "New Renewable Resources," of the Commission's June 2001 report, "Investing in Renewable Electricity Generation in California," subject to the enumerated additional requirements under § 383.5(d)(2). Thus, the required online date for a "new" facility should be as provided in the June 2001 Report. Table 2-1 of that report states that, to be eligible under the New Renewable Resources Account, a facility must be "newly built," repowered, or enhanced according to the criteria established in each auction. In past auctions, the "newly built" (or repowered/enhanced) criteria has meant being first placed in service after the CEC's Notice of Auction date.

The "newly built" requirement is appropriate for SEP payments awarded in conjunction with auctions held by the investor-owned utilities (IOUs).[2] In the case of other retail sellers -- energy service providers (ESPs) and community choice aggregators (CCAs), however, which may not hold auctions, the placed-in-service date could be after the date that the SEP award is made to the facility.

Under this formulation, "new" will always mean "new." As soon as a facility begins operating, it will no longer be eligible for a SEP award, which is appropriate since the facility was obviously able to arrange financing and to be constructed without the additional support. Such facilities would still be eligible for the utility contract.

Another important reason to stick with the "newly built" standard is to create consistency between in-state and out-of-state facilities. In order for an out-of-state facility to receive SEP funds, it must be "<u>developed</u> with guaranteed contracts to sell its generation to end use customers subject to the funding requirements of Section 381 …" P.U. Code § 383.5(d)(2)(B)(ii) (emphasis added). Establishing the same treatment for in-state and out-of-state facilities will reduce the vulnerability of the law to a Commerce Clause challenge.

Some have advocated that any facility built since 1996 be deemed eligible for SEP funds. If this standard were to be adopted, it would be inconsistent with past auction rules, and potentially open up the SEP fund to a considerable amount of existing out-of-state capacity (built since 1996), and thus fail to result in the development of new capacity. In some cases, this capacity was built with the support of favorable renewable energy policies in other states.

---

[2] CalWEA advocated in its May 5, 2003, Reply Brief before the CPUC that SEP awards should only be applied to IOU contracts that go through the utility's auction and least-cost, best-fit process, rather than in conjunction with bilaterally negotiated contracts. A reasonable exception would be to allow bidders with awards from past CEC auctions to apply those awards to bilateral contracts.

As implied above, under the "newly built" standard, the "new" (SEP-eligible) designation would only apply before the facility is placed in service. If the facility wins the utility auction and is above the market-price referent (MPR), it would receive SEP funds. If it wins the auction and is at or below the MPR, it would not need SEP funds and would not be eligible for SEP funds in the future.

2. Repowered renewable generation facilities are eligible for SEPs "if the capital investment to repower the existing facility equals at least 80 percent of the value of the repowered facility." Section 383.5 (d)(3) How should the CEC confirm that a repowered renewable generation facility meets this standard?

We wish first to point out that P.U. Code § 383.5(d)(2)(C)(i) is also relevant to this discussion. This subdivision of SB 1038 governs SEP eligibility for a repower that is completed under a QF contract.[3] We note also that our comments are written in view only of how these provisions would apply to wind facilities.

Second, it is necessary to define "repowered facility." Under the federal wind energy production tax credit (PTC),[4] a single turbine, together with its tower and pad, constitutes a separate facility.[5] For purposes of the SEP payment, a developer is unlikely to sell the output from a single turbine to a retail seller. However, partial project repowers are common, and it should be possible for a project owner (a) to bid into an IOU auction his incremental output from a full or partial project repower, which would augment production under its existing contract, or (b) when the contract expires, to sell the total output from a partially or fully repowered project to any retail seller.

A project owner seeking SEP funds for a repower should demonstrate that repowering has occurred for whatever number of turbines within its project that it seeks SEP funds for. A wind turbine automatically should be found to meet this standard if an old turbine is to be replaced with a new (i.e., not previously used) turbine, and its tower and pad are also replaced, since the total investment will clearly exceed 80% of the total value of the facility. In this case, the project owner should simply specify the number of turbines that are to be replaced, certify to the commission the date upon which those turbines have been replaced, and give the Commission the right to inspect the turbines.

A project owner that is not replacing the tower or pad, or both, along with the turbine (which probably will not be common) should be required to demonstrate that the total investment exceeds 80% of the total value of the facility. Again, this parallels the treatment of repowers under the federal PTC, wherein a facility can qualify for the PTC even though it contains some used property, provided the fair market value of the used property is not more than 20 percent of the facility's total value (the cost of the new property plus the value of the used property).[6]

Given that our proposal parallels the treatment of repowered facilities under the federal wind PTC (assuming that Congress extends it), and that most repowered facilities will also seek this tax credit and be subject to audit by the IRS, there will be a second check on these repowered facilities.

---

[3] A repower that is completed under existing QF contract would be eligible for SEP payments only for the incremental portion of output. A repower that is completed outside of a QF contract would be eligible for SEP payments for the entire output of the repowered facility, per P.U. Code § 383.5(d)(3).

[4] Section 45 of the Internal Revenue Code.

[5] "The Wind Energy Production Tax Credit: A User's Guide," American Wind Energy Association, 1994, p. 17-19. (Citing IRS Revenue Ruling 94-31, LTR 9417040, February 1, 1994.)

[6] *Ibid.*

3. Are renewable generation facilities that began receiving or have had funds encumbered from the New Account before January 1, 2002 eligible for SEPs? If yes, what conditions if any, would apply to the award of SEPs for these facilities?

Facilities that have received New Account awards should not be eligible for SEP funds. Though past awards were made for 5 years, as compared to the 10-year payments that will be made under the RPS, developers would have covered all of their expected above-market costs in their bid for the 5-year payment. There is no reason for the state to pay that cost twice.

Facilities that received New Account awards but whose awards have not yet commenced (because the facility has not been placed in service) should be eligible for SEP funds if they agree to relinquish their award upon winning an IOU auction (and ultimately signing a contract).[7] Many facilities that received awards were not able to develop their projects due to the lack of a market, and should be able to participate in the RPS market. Requiring them to give up their previous award upon winning an IOU auction is necessary to preserve SEP funds to increase the chance that the legislature's RPS goals will be met. Under the RPS, SEP awards will be granted only if the winning bidder's price is above the MPR. If a winning bidder with a prior award wins a contract at or below the MPR, the full cost should be paid by the utility, not by SEP funds.

The requirement that award-holders give up their prior award if they win the IOU auction is entirely fair, as their participation in the auction is entirely voluntary (especially since the prior awards, unlike SEP awards, are not restricted by type of purchaser; the award holder can sell to municipal utilities and even out-of-state purchasers). Further, the bidder's total bid price will be covered if they win the auction, whether by the utility contract alone or with a SEP supplement, so there is no basis for complaint.

4. To whom can SEPs be made: the facility owner/operator; the retail supplier; and/or potentially an intermediary that has taken possession of the renewable generation from the renewable generation facility and has the contract with the retail seller?

SEP payments should be made to the same entity that is party to the power purchase contract (whether it is the generator or an intermediary), and should be assignable if ownership of the contract is transferred or to provide security for the financing of the project. Making the SEP payment to the contract holder will ensure that the total bid price is covered and covered only once, and will support the financing of the project, since the contract will be tied to a particular new facility whether directly or through intermediaries.

A. SEP Payment

5. What are the performance standards for paying SEPs? Are there any circumstances where SEPs would be paid when generation has not occurred?

The Commission should not impose performance standards for SEP payments. Rather, the Commission should recognize that the power purchase contract will contain performance standards. SEP payments should be linked to performance under the contract, be paid out on a production (per kWh) basis, and be terminated if and when the contract is terminated. Instituting a second set of performance requirements would complicate financing, possibly increase financing costs, and possibly create uncertainty for the utility purchaser.

The RPS goals can be met only through the generation of renewable energy, because the environmental and economic benefits of renewable energy are produced only when renewable energy is produced. Therefore, with one exception, SEPs should be paid out on a

[7] The IOU should evaluate the bid without factoring in the prior PGC award.

production (per kWh) basis. The exception that would be warranted is making SEPs when the retail seller pays a generator to curtail production during a limited number of hours (such as during periods of overgeneration).[8] SEP payments during such periods will allow bidders to be certain that they will be paid their total bid price for curtailments, no matter how many hours they are ultimately curtailed. This revenue certainty will, in turn, reduce financing costs and encourage bidders to provide a curtailment option (which will contribute toward minimizing the number of ISO overgeneration hours). The retail seller has an inherent incentive to keep paid curtailed hours to a minimum.

6. On what frequency should SEPs be paid?

SEP payments should be paid on the same basis as contract energy payments, which is likely to be monthly.

7. Under what circumstances should SEPs be terminated for a facility? How would termination provisions in the CEC's SEP agreements affect the ability of new projects to secure financing, if at all?

See our answer to question 5. Linking the SEP award termination to the termination of the contract will not affect financing; imposing a separate set of termination provisions for the SEP award would increase the cost of financing by increasing the risk associated with the SEP income stream.

B. SEP Award and Allocation

8. SEPs are to be awarded only to facilities eligible for funding. At what point in the procurement process is funding eligibility established? At what point in the procurement process should funds be encumbered? How does the encumbering of funds, or the state's budget deficit, affect the ability of new projects to secure financing, if at all?

A facility should be able to apply for a determination of funding eligibility prior to the issuance of any RFO, starting as soon as possible. Projects in gray areas should be encouraged to seek advance certification. The eligibility guidelines should be clear enough for the developers of most technologies to anticipate their eligibility status. Advance certification will enable the IOUs to eliminate ineligible bidders before running them through the least-cost/best-fit evaluation process, and will facilitate timely project selection by the IOU and contract approval by the CPUC. If practicable for the CEC, however, projects should be able to apply for eligibility determinations before the closing date of the RFO and receive determinations prior to a utility's selection of bid winners.

Funds should be tentatively reserved when a utility seeks approval for a contract from the CPUC; funds should firmly committed when the contract is approved by the CPUC (but potentially conditioned, e.g., if the project's eligibility status is conditioned on obtaining CEQA approval).

If SEP awards are less than fully guaranteed, lenders will discount the income stream from the award, which will increase financing costs. The higher bid prices that result will reduce the degree to which the legislature's RPS goals are met, such that the SEP fund does not end up supporting achievement of the RPS goals as intended by legislature. Therefore, the Commission should investigate ways of safeguarding committed awards, such as putting them in an escrow account or bonding them, seeking legislative authorization if necessary. In addition, to the extent possible, the CEC should use the SEP funds that have already been collected to cover the entire SEP awards of the projects in the current cycle. For example, 2004 SEP funds should be used to

---

8 If the contract does not pay for curtailments, then SEPs should not be paid, since the bidder would have included these costs elsewhere in his bid price.

cover the 10-year awards of projects selected in the 2004 procurement cycle (rather than using SEP funds from multiple years to cover all awards).

CalWEA and others have advocated that the CPUC adopt compliance deferral mechanisms that will allow a utility to postpone compliance with an annual RPS target by signing contracts for later deliveries that will make up for the earlier deficits. The need to guarantee SEP funds to projects that sign those contracts could introduce a timing problem if sufficient SEP funds have not been collected and safeguarded at the time that the contracts are signed. In this case, contracts may have to be conditioned upon the collection and safeguarding of the SEP award. The utilities should only sign such contracts when this Commission expects such SEP funds to be available. In addition, it may be necessary for the Commission to adopt rules for the second five-year period (2007-2011) of PGC funding under SB 1194/AB 995 at least two years in advance of the second five-year period so that awards for the early years of that second five-year period can be made in advance.

9. Under what conditions, if any, should the CEC facilitate or administer auctions for SEPs?

The CEC should determine now that it will not be administering auctions for SEP awards for projects selling to the IOUs. SEP awards for these projects should only be made in conjunction with each IOU's least-cost, best-fit process, with awards going to the projects selected under that process.

The Commission might want to consider administering auctions in order to facilitate compliance with the RPS by ESPs or CCAs.[9] At this point, CalWEA has no recommendations in this regard. We suggest that this commission consider this issue concurrent with or after the CPUC establishes the rules for ESP and CCA compliance with the RPS.

10. Under what conditions, if any, should the CEC apply targets, milestones, or other conditions as requirements for SEP payment?

See our answers to questions 5 and 7. The CEC should not any establish any such conditions on the SEP award. Rather, the SEP award should be linked to the power purchase contract, which will include these types of conditions to ensure timely project development.

11. The CEC has authority to require a forfeitable bid bond or other financial guaranty from applicants competing for funding. Under what conditions should the CEC exercise this authority? Which form(s) of financial guaranty are appropriate for the CEC to accept?

See our answers to questions 5, 7 and 10. The contract is likely to contain credit requirements, as well as project milestones. Additional requirements will unnecessarily complicate financing and increase costs.

12. The CEC has authority to consider establishing caps on SEPs.
383.5 (d)(2)(A)(i) The Energy Commission may establish caps on supplemental energy payments. The caps shall be designed to provide for a viable energy market capable of achieving the goals of Article 16 (commencing with Section 399.11). The Energy Commission may waive application of the caps to accommodate a facility, if it is demonstrated to the satisfaction of the Energy Commission, that operation of the facility would provide substantial economic and environmental benefits to end use customers subject to the funding requirements of Section 381.

---

[9] It is likely that ESPs will serve as the retail sellers for CCAs (since municipalities generally will not want to take on the risk and responsibilities of actually providing power, but will prefer to serve instead as a bargaining agent), in which case the CCA would not actually be the entity obligated to comply with the RPS.

i. On what basis, if any, should SEPs be capped? a. Per unit production; b. By time period, such as a utility's procurement cycle; c. By retail seller or category of retail seller (e.g., UDC, ESP); d. Relative to the market price referent or the balance remaining in the New Account. e. Other?

Items (a) and (d) (per-kWh caps or caps relative to MPR) for IOUs: CalWEA has advocated least-cost, best-fit (LCBF) bid evaluation guidelines that would result in the selection of the least-cost renewable projects. Assuming a competitive auction,[10] our proposed process should maximize the number of kilowatt-hours funded with available SEP funds. If the CPUC adopts such a process, then it would be both unnecessary and counterproductive to superimpose SEP caps of any kind on projects selling to an IOU.[11]

Caps would be unnecessary because the results of competitive bidding will be the best indicator of the cost of renewables, and the LCBF process will ensure that the SEP funds are efficiently spent. Caps could be counterproductive because they may be established at levels that are not representative of actual project costs, and could lead to an impasse. An impasse could occur if the CEC determines that a project should cost no more than X cents/kWh but, for various reasons (e.g., because exchange rates have driven up the cost of imported equipment, or perhaps because of onerous contract terms), a utility has selected and the CPUC has approved a particular project at X+1 cents/kWh because it was the lowest-priced renewable bid. The CEC's cap would prevent the project from obtaining SEP funds, and thus prevent the least-cost developer from executing the utility contract.

If the LCBF process adopted by the CPUC does not, however, result in maximizing the number of kilowatt-hours supported by the SEP fund (e.g., if a utility is able to select high-cost projects when lower-cost projects that satisfy need were available, then the Commission should carefully consider SEP caps[12]). It would be premature at this point to consider all of the possible policy outcomes at the CPUC, and the ways in which the utilities might try to frustrate the CPUC's rules. This Commission and the parties should revisit this issue after the CPUC has adopted its LCBF rules, and then revisit the issue as necessary after experience is gained. If caps are needed, it will be an indication that the LCBF process was poorly designed or wrongly executed and that adjustments are necessary. The adjustments should be made to the LCBF process, however, such that caps are not needed.

Items (a) and (d) for other retailers: Since non-IOU retail sellers will not be subject to the regulated LCBF process, it is appropriate to put some other type of check on the SEP payments made to their renewable suppliers. For example, one possible method would be to link the cap to the payments that are made to renewables under IOU contracts, such as limiting the average SEP payment made to an ESP's renewables to no greater than 110% of the average payment made to the IOUs' renewables. It may also be necessary to require the ESPs, using their allocation of SEP funds, to meet the same fraction of the RPS obligation as is met by the IOUs.

---

[10] If the auction is not competitive, the CPUC should require contract renegotiation or a new auction. P.U. Code § 399.14(c).

[11] Of course, the IOU should only execute contracts for which SEP funds are available to cover the total bid price.

[12] For example, if the projects selected by utility A require average SEP payments of 0.5 cents/kWh and utility B's projects require an average SEP payment of 3 cents/kWh, and the difference is not explained by a difference in the resources that can be delivered to the utility, then both Commissions should consider utility B's results suspect and its LCBF process and contract terms should be reviewed and revised. If they are not, then the CEC should consider payment caps, in order to preserve SEP funds. If the difference in cost can be legitimately explained, and the CPUC has approved tradable Renewable Energy Credits as a means to satisfy the RPS obligation, then the CPUC should require utility B to demonstrate why it should not instead arrange to purchase RECs from utility A.

Items (b) and (c) for all retail sellers. See our response to Question 13.

ii. What methodology should the CEC adopt to confirm that the "substantial economic and environmental benefits" condition exists?

If the CEC establishes caps, which, as explained above, we hope is not necessary, it should impose caps that try to approximate what the results would have been had the utility followed an appropriate LCBF and contracting process. (As noted above, this would lead to an impasse, but would at least conserve PGC funds if they would otherwise be unnecessarily squandered.)

If the CEC wishes to make an occasional exception for a particular project, and that project has been selected pursuant to the LCBF process and any related CPUC rules, it should require a demonstration of "substantial economic and environmental benefits" relative to other renewables, and apart from any emerging technology or RD&D values, as the state explicitly funds those values with a separate portion of the PGC fund.

13. The CEC has the responsibility to manage funds given multiple retail sellers and categories of retail sellers. 383.5 (d)(2)(A)(v) Funds shall be managed in an equitable manner in order for retail sellers to meet their obligation under Article 16 (commencing with Section 399.11). **Whether or not caps are established, should the CEC allocate available funding among retail sellers or retail seller categories?**

Each retail seller should have access to its pro-rata share of the annual SEP fund (i.e., the portion of the SEP fund paid by its own customers) for a reasonable period of time, such as until the end of the compliance year, or as soon as the retailer's annual obligation is fulfilled, whichever is sooner. However, consistent with the CPUC's adopted compliance flexibility mechanisms, each retailer also should have the ability to reserve their future years' pro-rata share of funds if it is contracting in early years for deliveries later.

Unused funds, on an annual cycle, should be rolled over into a general SEP fund that would be available to support retailers with higher percentage obligations or whose renewable resource costs are legitimately higher (see footnote 11). All customers will gain from the environmental and economic benefits of renewable resource development (such as the general price reductions resulting from reduced gas demand), and so there is no need for a strict match between the SEP funds contributed by a retailer's customers and the SEP funds paid to that retailer's renewables suppliers (in fact, once a retailer complies, there may be no use at all for its SEP funds). It is reasonable to provide for an initial "soft" allocation of funds to each retailer, however, as a particular retailer's customers will gain some direct benefits from having fixed-cost renewables in their retailers' portfolio.

14. The CEC may provide funding preference based on the following: *383.5 (d)(2)(F) In awarding funding, the Energy Commission may provide preference to projects that provide tangible demonstrable benefits to communities with a plurality of minority or low-income populations.* **How should the CEC establish that such a condition exists? Under what conditions would such a preference be applied?**

As there is a similar provision in SB 1078, allowing the utilities to provide preference to projects benefiting low-income and minority populations, the Commission should defer to the CPUC's rules on this issue and fund any such projects that are awarded contracts under the CPUC's rules. For example, if the CPUC decides, as TURN/SDG&E have advocated, that the low-income preference should be used as a tie-breaker, the CEC should not impose any additional conditions. However, the CEC could assist the CPUC in establishing guidelines for what projects qualify under this provision.

15. If funding demand exceeds supply, how should the CEC allocate funding among eligible facilities?

As part of any IOU solicitation, the CEC should fund the facilities that have been approved by the CPUC that require the lowest per-kWh SEP award. If the solicitations of more than one IOU or other retail seller SEP requests are sufficiently proximate, the CEC should likewise fund those facilities that will generate the greatest number of renewable kWh, regardless of whose portfolio they are in. If there are insufficient funds to fully cover the award of the least-cost facility, that facility together with the contracting retail seller should have the option of down-sizing the contract or accepting a smaller award. If the award is declined, it should go to the next least-cost facility.

16. In the implementation of the New Renewables Resources Account from 1998 to 2002 under Senate Bill 90 (Chapter 854, Statutes of 1996), projects were limited to receive no more than 25 percent of the funds available from each auction. Should such a limit remain in place consistent with the prior program provisions?

This Commission should consider this question after the CPUC has established its compliance flexibility rules and non-compliance penalties. If retail sellers are fully responsible for ensuring that they comply with their RPS requirements, then it would not be necessary for the CEC to impose a requirement that assures some project diversity. If, however, under the CPUC's rules, a retail seller could be excused if it "put all its eggs in one basket" by relying on a single renewable supplier to develop a very large, risky project and failed to enforce milestone requirements, then the 25 percent limit should be retained.

17. How will the awarding of SEPs interact with the CEQA requirements for project development?

The CEC should condition a SEP award upon the obtainment of any necessary CEQA approvals (or other regulatory requirements that bear on eligibility) if such approvals have not been obtained at the time that a facility's contract has been approved by the CPUC.

<u>Reporting and Verification</u>

CalWEA has no comments at this time on the remaining questions on reporting and verification.

18. What entities are responsible for reporting the term of the contract for eligible generation (383.5 (d)(2)(A)(iii)) and the actual generation eligible for SEPs? *383.5 (d)(2)(A)(iii) Supplemental energy payments awarded to facilities selected by an electrical corporation pursuant to Article 16 (commencing with Section 399.11) shall be paid for the lesser of 10 years, or the duration of the contract with the electrical corporation. 383.5 (d)(2)(A)(iv) The Energy Commission shall reduce or terminate supplemental energy payments for projects that fail either to commence and maintain operations consistent with the contractual obligations to an electrical corporation, or that fail to meet eligibility requirements.*

19. What data sources should be acceptable for reporting eligible generation to claim SEPs?

20. What standard of review by the CEC is appropriate for confirming data reporting SEP eligible generation?

21. On what frequency is eligible generation reporting required for SEPs?